IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 96-2440

FEDERAL TRADE COMMISSION

Plaintiff-Appellant

v.

BUTTERWORTH HEALTH CORPORATION, a Michigan corporation;
BLODGETT MEMORIAL MEDICAL CENTER, a Michigan corporation

Defendants-Appellees

On Appeal from the United States District Court
for the Western District of Michigan
Case No. 1:96-CV-49

BRIEF FOR PLAINTIFF-APPELLANT FEDERAL TRADE COMMISSION

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STATEMENT IN SUPPORT OF ORAL ARGUMENT PURSUANT TO LOCAL RULES 9(d) and 10(e)

This case involves a proposed merger between the two pre-eminent hospitals in Grand Rapids, Michigan: Butterworth Hospital and Blodgett Memorial Medical Center. Each firm is the other's only close competitor, and health care plans must offer access to one of the two rivals in order to gain the patronage of consumers. The district court, while acknowledging that the combination would give the merged entity "substantial market power in two relevant markets" (R.200 Opinion ("Op.") 41, APX 73), denied the Commission's request for a preliminary injunction on the theory that the new nonprofit hospital's board of directors would exercise such market power benevolently. Hoping to assure that the combined entity would not abuse its impending market dominance, the court conditioned the denial of injunctive relief upon the hospitals' acceptance of a "consent order" that loosely governs aspects of their post-merger pricing and profits.

The Federal Trade Commission has pursued this appeal because the court's decision fails to enforce the Clayton Act's prohibition against mergers that "may tend substantially to lessen competition," sanctions elimination of competition that has benefited the consumers of Grand Rapids, substitutes a judicially-regulated quasi-monopoly for the regime of competition mandated by Congress, and may render more difficult (if not entirely preclude) the entry of effective relief following completion of the administrative proceeding that will decide the legality of the merger. In light of the novelty of the district court's approach and the broad importance of the issues that it raises, both for competition in the hospital markets directly affected and for administration of the Clayton Act generally, the Commission requests that oral argument be heard.

JURISDICTIONAL STATEMENT

(1) The complaint filed by the Federal Trade Commission ("FTC" or "Commission") seeks a statutory preliminary injunction under § 13(b) of the FTC Act, 15 U.S.C. § 53(b), to prevent consummation of a proposed merger during the pendency of administrative proceedings that will determine whether the merger violates Section 7 of the Clayton Act, 15 U.S.C. § 18. The district court had jurisdiction to decide the suit under 15 U.S.C. §§ 18 and 53(b); and 28 U.S.C. §§ 1331, 1337(a), and 1345.

(2) This Court has jurisdiction of the Commission's appeal under 28 U.S.C. § 1291 (review of final orders) because, by denying the only relief requested by the Commission (a statutory preliminary injunction), the district court disposed finally of the case. FTC v. Food Town Stores, Inc., 539 F.2d 1339, 1343 (4th Cir. 1976). This Court also has jurisdiction under 28 U.S.C. § 1292(a)(1) (review of denials of injunctive relief). The Commission's November 19, 1996, notice of appeal from the district court's final judgment of October 28, 1996, is timely pursuant to Fed. R. App. P. 4(a)(1).

STATEMENT OF ISSUES

1. Whether, having found that a proposed merger of two hospitals would give the merged entity "substantial market power in two relevant markets," the district court erred as a matter of law in declining to enjoin preliminarily the merger on the theory that "even though competition may be lessened, the interests of consumers are * * * likely to be advanced."

2. Whether the district court erred as a matter of law in concluding that the nonprofit status of the merging hospitals constituted a substantial reason for allowing a merger that is likely to lessen competition by creating a firm with power to dictate prices to its customers; and whether the district court's conclusion that nonprofit hospitals that gain market power by merger are likely to behave differently from similarly-situated for-profit firms is clearly erroneous.

3. Whether the district court erred as a matter of law by relying on the merging parties' promise of operating and "capital avoidance" efficiencies to deny preliminary injunctive relief against a proposed merger that would create a firm with market power, where the court did not determine that such efficiencies would contribute to the promotion of competition and did not explain the basis for the estimate of efficiencies that it reached.

4. Whether, apart from errors of substantive antitrust law, the district court misapplied the standard governing granting of preliminary injunctive relief under Section 13(b) of the FTC Act by declining to enjoin preliminarily a merger that it found would "without question" create a firm with "market power," on the basis of unprecedented, highly controversial contentions regarding efficiencies and the behavior of nonprofit firms that the court recognized it was unable to resolve definitively in a preliminary hearing.

CONCISE STATEMENT OF THE STANDARD OF REVIEW FOR EACH ISSUE

"The standard of review on appeal from the grant or denial of a preliminary injunction is * * * whether the district court abused its discretion." Christian Schmidt Brewing Co. v. G. Heileman Brewing Co., 753 F.2d 1354, 1356 (6th Cir.), cert. denied, 469 U.S. 1200 (1985). "A district court abuses its discretion when it relies on clearly erroneous findings of fact or when it improperly applies the law or uses an erroneous legal standard" (id., citations omitted). Issues 1, 3, and 4 above raise questions of law and the application of legal standards, as to which the district court's decision is reviewed de novo. Loudermill v. Cleveland Bd. of Educ., 844 F.2d 304, 308 (6th Cir.), cert. denied, 488 U.S. 946 (1988). Issue 2 raises a question of law, subject to de novo review, and a question of fact, as to which the court's decision is reviewed for clear error. Id.

STATEMENT OF THE CASE

A. Nature of the Case and Course of Proceedings Below

This is a suit for a statutory preliminary injunction under § 13(b) of the FTC Act, 15 U.S.C. § 53(b), to prevent consummation of a proposed merger between Butterworth Health Corporation ("BHC") and Blodgett Memorial Medical Center ("BMMC"). The requested preliminary injunction would last until the completion (including any appellate review) of an FTC administrative proceeding (In re Butterworth Health Corp. et al., No. 9283 (complaint issued Nov. 18, 1996)), initiated pursuant to Section 11 of the Clayton Act, 15 U.S.C. § 21, to determine whether the merger is unlawful under § 7 of the Clayton Act, 15 U.S.C. § 18.[1] The Commission's complaint for preliminary injunction was filed on January 23, 1996 (R.1, APX 24). Following discovery, the district court (Judge David McKeague) held a preliminary injunction hearing on April 22-26, 1996. Thereafter the parties submitted post-trial briefs and proposed findings. (R.172-176, 184-185, APX 21.)

On September 26, 1996, the court issued its decision, stating that it would deny the Commission's request for injunctive relief, on condition that defendants submit, for issuance by the court, a "consent order" embodying the defendants' "Community Commitment" to limit price increases for a period of time following the merger (R.200 Op. 1-44, APX 33-76). On October 28, 1996, the district court entered a "Consent Decree" (signed and approved only by defendants)

[1] Section 13(b) of the FTC Act authorizes the Commission to seek, and the district court to grant, preliminary relief "pending the issuance of a complaint by the Commission and until such complaint is dismissed * * * or until the order of the Commission made thereon has become final * * *." Section 7 of the Clayton Act prohibits acquisitions the effect of which may be to "substantially lessen competition" in "any section of the country." Section 11 of the Clayton Act authorizes the Commission to determine the legality of such acquisitions in administrative adjudicatory proceedings, subject to review in the court of appeals. Relevant portions of these statutory provisions are reprinted in the Addendum.

by which defendants are ordered to abide by the "Community Commitment" attached thereto (R.206, APX 77-95). The court simultaneously entered a "Judgment Order" that denied the Commission's request for preliminary injunctive relief (R.207, APX 96-97). The Commission filed its notice of appeal on November 19, 1996 (R.208, APX 98). The defendants have agreed to refrain from consummation of their merger pending this expedited appeal.

B. Statement of the Facts

1. The Parties to the Transaction

Defendant BHC, a non-profit corporation, owns Butterworth Hospital ("Butterworth"), a general acute care hospital that operates 529 beds in downtown Grand Rapids, Michigan's second-largest city. (R.101 Stipulated Facts ##1, 29, APX 134, 142; R.200 Op. 2, APX 34.) Defendant BMMC, also a non-profit corporation, owns Blodgett Memorial Medical Center ("Blodgett"), a general acute care hospital that operates 328 beds in East Grand Rapids, less than three miles from Butterworth. (R.101 Stip. Facts #39, APX 143; R.200 Op. 2, APX 34.)

Both Butterworth and Blodgett are "prospering, well-managed hospitals" (R.200 Op. 3, APX 35).[2] They are by far the largest, most sophisticated hospitals in Grand Rapids and greater

[2] For the fiscal year ending June 30, 1995, Butterworth's revenue totalled almost $291 million, about 72% of which was attributable to general acute care inpatient services. Blodgett's revenue exceeded $160 million, about 68% of which was attributable to inpatient services. (R.101 Stip. Facts ## 33, 41, APX 10-11.) From 1991-95, Butterworth's operating margins have ranged from 6.8% to 13.8%, and Blodgett's from 6.2% to 9.3%, far above the 3.5-3.8% median operating margin for all acute care hospitals during this same period (R.101 Stip. Facts ##51-53, APX145). The total value of defendants' combined assets exceeds $600 million (R.36 Answer ¶ 8, APX 104; R.1 Complaint ¶ 8, APX28). The June 1995 net worths of Butterworth and Blodgett hospitals were $185 million and $117 million, respectively (R.101 Stip. Facts #54, APX 145).

Kent County, possess extensive physical facilities and ample capital reserves, and offer a wide range of primary, secondary, and tertiary inpatient care (R.101, Stip. Facts ##29-57, APX 9-13).[3]

2. The Relevant Markets in Which the Merger Is Evaluated

a. Product Markets

The district court concluded, as the Commission had alleged, that "for purposes of the motion for preliminary injunction * * * general acute care inpatient hospital services is a relevant product market" (R.200 Op. 10, APX 42). This market encompasses a "cluster of services and capabilities that are provided only by general acute care hospitals and for which there are no reasonable substitutes," and includes such services and capabilities as "operating rooms, anesthesia, intensive care capabilities, 24-hour nursing care, lodging, and pharmaceuticals" (id. at 8, APX 40). The district court also found, as the Commission alleged, "that primary care inpatient services is a [second] relevant product market," comprising "basic or less complex services available at most general acute care hospitals," including "normal childbirth, gynecology, pediatrics, general medicine and general surgical services" (id. at 10, APX42).

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[3] Butterworth itself devised the idea of merger with Blodgett in a board meeting in June 1993. See Plaintiff's Exhibit ("PX") 372 at 3427, 3457-58, 3461, 3463, 3466, 3469, APX 627-33. Several years ago, before the present merger was considered, Blodgett declared its intention to construct a new physical plant on the Beltline, to the east of its present site. Announcement of this plan was among the factors that led to the formation of the Kent County Area Health Care Facilities Study Commission ("Hillman Commission") (R.200 Op. 4, APX 36). In its May 1994 final report, the Hillman Commission concluded, inter alia, that Blodgett should abandon its plans for a replacement facility because it "has not demonstrated that it has exhausted all possibilities of utilizing all space on its present campus * * *. " Defendants' Exhibit ("DX") 685 at 28, APX 825. The Hillman Commission suggested that, instead of constructing a replacement facility, Blodgett should consider the options of reorganizing present facilities onsite, moving outpatient facilities offsite while keeping inpatient services onsite, and consolidating inpatient services with other area hospitals. Id. at 28, 30, APX 825-26. The Hillman Commission never considered, let alone recommended, a merger between Blodgett and Butterworth.

b. Geographic Markets

Again "for purposes of preliminary injunctive relief," the district court found that "the relevant geographic market for general acute care inpatient hospital services is the greater Kent County area, as defined by the FTC" (R.200 Op. 16, APX 48). This includes Grand Rapids and the area within a 30-mile radius of Grand Rapids, consisting of Kent County and portions of seven adjoining counties (id. at 12, APX 44). Evidence showed that "major managed care organizations and major employers in Grand Rapids who purchase health care services on behalf of their members and employees * * * would not attempt to steer their members or employees, respectively, away from Grand Rapids in response to a 5 to 10% price increase by the merged entity" because of "the strong bias among their members and employees in favor of local health care due to perceived quality of care and convenience" (id. at 15, APX 47).

The district court also found that, for purposes of preliminary injunctive relief, the Commission "adequately defined the relevant geographic market for primary care inpatient hospital services as the immediate Grand Rapids area" (R.200 Op. 17, APX 49). This smaller market contains approximately 70 zip code areas, from which the Grand Rapids hospitals draw the vast majority of their primary care patients, and whose residents receive the vast majority of their primary care inpatient services from the four Grand Rapids hospitals (id. at 16-17, APX 48-49).

3. Anticompetitive Effects of the Merger

As the district court recognized, the merger, if consummated, will establish Butterworth/Blodgett as the dominant firm in a market that is already highly concentrated (R.200 Op. 19-20, 41, APX 51-52, 53). Butterworth/Blodgett would control between 65% and 70% of the immediate Grand Rapids primary care inpatient hospital market, depending on whether market share is measured by licensed beds, patient discharges, or inpatient revenues (id. at 20, APX 52). The post-merger Herfindahl-Hirschmann Index (HHI) would range from 4506 to 5079 (an increase of 1675 to 2001 points) (id.).[4] The combined entity would hold 47% to 65% of the market for general acute care inpatient hospital services in Greater Kent County, and in that market the post-merger HHI would range from 2767 to 4521 points (an increase of 1064 to 1889 points) (id. at 19, APX 51). As the district court found, these concentration increases and resultant concentration levels in well-defined markets exceed the thresholds found by courts to establish a prima facie case that a merger would violate Section 7 of the Clayton Act (id. at 20, APX 52).

As the district court also found, the evidence shows that this merger will confer upon Butterworth/Blodgett "substantial market power in two relevant markets" (R.200 Op. 41, APX73), that is, the power unilaterally to impose increased prices on purchasers of primary and other acute care inpatient hospital services in the Grand Rapids area. Such single-firm market power would result from the merger because the principal purchasers of hospital services in the Grand Rapids area (third party payors including managed care plans, other insurance companies,

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[4] Courts and the Department of Justice Antitrust Division/Federal Trade Commission Merger Guidelines, 4 Trade Reg. Rep. (CCH) ¶ 13,104 (1992), utilize the HHI to measure market concentration. See, e.g., FTC v. PPG Industries, Inc., 798 F.2d 1500, 1503 (D.C. Cir. 1986). The HHI is calculated by squaring the market share of each competing firm and summing the resulting numbers. For example, for a market consisting of three firms with shares of 50, 30, and 20%, the HHI is 3800 (50 x 50 plus 30 x 30 plus 20 x 20 = 3800). The HHI approaches zero when a market is served by a large number of firms of relatively equal size, and reaches its maximum of 10,000 when a single supplier exists in the market. Under the Merger Guidelines (§ 1.51), mergers resulting in an HHI over 1800 and an increase of more than 100 points are “presumed * * * likely to create or enhance market power or facilitate its exercise.”

and employers) generally agree that they must provide their enrollees or employees in the Grand Rapids area with access to at least one of the two merging hospitals.[5]

Purchasers do not regard the other two, much smaller hospitals in Grand Rapids (St. Mary's Health Services and Metropolitan Hospital) as adequate substitutes for Butterworth and Blodgett. These two hospitals could not constrain price increases by a combined Butterworth/Blodgett "due to the greater range of services and the perceived higher quality of care available at defendant hospitals" (R.200 Op. 29, APX 61). St. Mary's, which operates approximately 150 acute care beds (id. at 3, APX 35), has the oldest physical plant in Grand Rapids and provides, for the most part, only primary and basic secondary care, including much of the care for the indigent in Grand Rapids (id.; PX105: Ameen Decl. ¶¶ 4-5, APX 425). Metropolitan, "an osteopathic hospital that operates approximately 101 general acute care beds," provides "primary care and limited secondary care services, but no tertiary care services" (R.200 Op. 3, APX 35).[6]

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[5] R.201 Vol. I Trial Transcript ("I Tr.") 87, 90-91 (Palmer), APX169, 170-71; I Tr. 281-82 (Williams), APX191-92; I Tr. 247 (Sommers), APX 184; R.202 II Tr.13-14 (Levin), APX 200-01; II Tr. 141-44 (Pries), APX 221-24; PX 105: Ameen Decl. ¶¶ 13, 19, APX 427-29; PX 106: Andros Decl. ¶¶ 4-6, 8, APX431-32; PX 108: Beard Decl. ¶ 9, APX 436; PX 117: Franzese Decl ¶ 7, APX438; PX 126: Kieffer Decl. ¶ 2, APX 442; PX 127: Knape Decl. ¶¶ 9-11, APX 445-46; PX 130: Levin Decl. ¶ 8, APX 449; PX 134: McMillan Decl. ¶¶ 4-5, 8-9, APX 452-54; PX135: Mudler Decl. ¶ 11, APX 456; PX 136: Nagelhout Decl. ¶¶ 3-4, APX 458-59; PX 137: Palmer Decl. ¶¶ 1-7, APX 460-66; PX142: Shemanski Decl. ¶¶ 3-4, APX 471-72; PX 144: Sommers Decl. ¶¶ 3-6, APX 473-75; PX149: Williams Decl. ¶¶ 5-17, APX 483-89; PX 151: Governile Decl. ¶ 4, APX 492A; PX270: Black Tr.90, APX 515; PX289: Levin Tr. 88-89, APX522-23; PX295: Palmer Tr. 185-86, APX 527-28; PX 305: Zech Tr.126, APX 530; PX 313: Eisenstadt Tr. 223-24, APX 534-35.

[6] St. Mary's and Metropolitan are the only other hospitals in the greater Grand Rapids market for primary care. The greater Kent County market for all acute care inpatient services also includes five other -- primarily rural -- hospitals, one of which is managed by Butterworth. Due to their predominantly rural locations, limited services (at most, only primary and basic secondary care), and lesser reputations, these hospitals are not regarded, even in their own estimations, as effective competitors of Butterworth and Blodgett. (PX 145: Ulmer Decl. ¶¶ 4-5, 8, APX477-

In addition, as the court found, "defendants concede that there are substantial barriers to new entry into the relevant market" (R.200 Op. 28, APX 60). Although anticompetitive exploitation of market power "is likely to be deterred if other competitors may easily enter the market," Grand Rapids is "already served by sufficient inpatient hospital bed capacity and authorization for construction of a new general acute care hospital in the area is not likely to be granted under Michigan's 'certificate of need' laws" (id.).

Finally, the court recognized that one of the principal stated purposes of the merger is to enable Butterworth/Blodgett to exercise market power by "level[ing] the managed care organization playing field" (R.200 Op. 32, APX 64). As a result of existing competition between Butterworth and Blodgett, some managed care companies, which provide health care services to about 200,000 residents in the Grand Rapids area, have been able to negotiate substantial reductions from regularly-charged prices, with the size of the reduction depending upon the company, the hospital, and the nature of the services involved. See, e.g., R.201 I Tr. 271 (Williams), APX 271; I Tr. 84 (Palmer), APX 168; PX 246 at 1-4, APX 510-13. Butterworth and Blodgett have promised that for the first few years after the merger, the merged entity will charge the four major managed care companies rates equal to the weighted average of the rates currently paid by all four of them, while different levels of discounts would be offered to the minor managed care companies and to new managed care entrants. R.206, Att. 1 "Defendants Statement of Actions Planned in the Event of a Merger" at 4-5, APX 84-85. The merged entity's ultimate goal is to eliminate all discounts to managed care. See PX 5 at 19, APX 403; PX 82: DeVos Tr. 163-64, APX 420-21; R.203 III Tr. 249 (DeVos), APX 309. Without the merger,

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79; PX 146: Veenstra Decl. ¶¶ 3-6, APX 480-81; PX 137: Palmer Decl. ¶ 5, APX 464-65; PX 127: Knape Decl. ¶ 11, APX 446; PX 151: Governile Decl. ¶¶ 12-13, APX 492B-C.)

defendants have acknowledged that neither hospital alone would have the market power to impose the price increases necessary to accomplish this price equalization, because any disadvantaged purchaser would be able to steer its subscribers to the other hospital. See R.203 III Tr. 201 (Wagner), APX 299; R.205 V Tr.179 (Eisenstadt), APX 382; PX 313: Eisenstadt Tr.311, APX 536.[7]

Although recognizing that the merger would suppress or eliminate price competition, the district court was not troubled by this prospect, stating that "selective price advantages [to aggressive purchasers] are hardly the sort of benefit the antitrust laws are designed to protect" (R.200 Op. 33, APX 65). Likewise, the court did not consider it beneficial that further competitive price reductions to other purchasers could be funded through a "reduction of defendants' above-average profit margins," because "[w]ith nonprofit hospitals * * * reduced operating margins simply mean less funds to reinvest in each hospital" which the court believed "could only have adverse effects on the quality of care provided" (id. at 34, APX 66). The court thus found itself "not at all persuaded" that "continuation of the current competition" would yield "benefits to consumers as a whole superior to those likely to be realized in the event of the merger" (id.).

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[7] Defendants' plans for exercising market power extend beyond managed care organizations to include Grand Rapids area employers who self-insure their employees and pay defendants' list prices. In recent years, such employers have responded to the increasing cost of health care by pressuring defendants for price reductions like those obtained by managed care companies (PX 213 at 5712, APX 500A), a development that reached its apex in late 1995 when Blodgett, after learning that Butterworth had begun offering substantial discounts to certain of these employers, responded with a plan to offer comparable discounts (PX 258 at 1907-13, APX 1099-1105 (in camera folder)). Once merged, however, defendants would freeze the list prices paid by these employers (R.206, Att. 1 at 3, APX 83), leaving prices higher than they would be if this budding rivalry for self-insured employers' business continued.

4. Alleged Efficiencies Created by the Merger

The parties disagreed sharply about the magnitude and relevance of efficiencies that might be yielded by the merger. The district court stated that "measuring the efficiencies of a proposed transaction is inherently difficult" (R.200 Op. 38, APX 70), deemed it "neither appropriate nor necessary to engage in a detailed evaluation of the competing views" (id.), but nonetheless concluded that the proposed merger would result in "significant efficiencies, in the form of capital expenditure avoidance and operating efficiencies, totaling in excess of $100 million" (id. at 39-40, APX 71-72).

The court did not explain how the efficiencies it found would promote competition, nor did it attempt to weigh the efficiencies it found against the merged entity's power to increase prices that would result from the elimination of competition between Butterworth and Blodgett.[8] The court also did not explain how it arrived at its estimate of efficiencies or what portion of its estimate constituted so-called "capital expenditure avoidance" (that should presumably be amortized over a lengthy period of time)[9] and what constituted operating efficiencies. Instead,

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[8] The Commission alleged that, when properly amortized, defendants' reasonably estimated efficiencies, even if realized, represented only a few percent of their yearly sales of inpatient hospital services. Accordingly, any efficiencies would be more than outweighed by the increases in price that a firm with market power would be able to impose (R.202 II Tr. 258-59 (Leffler), APX 242-43; R.205 V Tr. 303 (Taylor), APX 394). The Commission also pointed out that any measurement of efficiencies must consider the likely inefficiencies created by a merger that eliminated competition, for example, reduction in defendants' incentive to engage in cost-control measures (see p. 41, infra).

[9] The hospitals argued that Blodgett planned to build a new $187 million "hospital of the future" to compete with Butterworth, whereas, if a merger eliminated Blodgett's need to compete, much cheaper facilities could be built to house Blodgett's patients, resulting in a net capital avoidance savings of $99 million. The Commission argued that, to account for the differences in quality between the two alternatives, any "savings" from defendants' omitting the state-of-the-art features and other cost items in a new Blodgett facility (e.g., all private rooms) must be reduced "so that the effect of extra cost for extra quality was mitigated" (PX 363 at 4, APX 561). See generally id. at 1-10, APX 558-67. The Commission also contended that any savings must be amortized

the court reasoned that, as nonprofit institutions providing community service, the defendants would endeavor to charge reasonable prices, and that the above-normal margins that Butterworth/Blodgett was likely to maintain as a result of its market power would necessarily be spent to improve the institution. Such improvements, the court concluded, would yield benefits to consumers in the form of higher quality services and the creation of "world-class health facilities in West Michigan, a course the Court finds clearly and unequivocally would ultimately be in the best interests of the consuming public as a whole" (R.200 Op. 42, APX 74).

Assessing the Commission's ultimate likelihood of success on the merits, the court found that defendants had established that "even though competition may be lessened, the interests of consumers are, under the unique circumstances of this case, likely to be advanced rather than hurt, through the provision of more efficient, higher quality, and lower cost health care" (R.200 Op. 40, APX 72). For this reason, the court concluded that preliminary injunctive relief should be denied.

5. The "Community Commitment"

As a condition of denying the Commission's request for preliminary injunctive relief, the court, in its opinion of September 26, 1996, directed the defendants to submit a proposed "Consent Order." The "Consent Order," entered by the court on October 28, 1996, requires the defendants to abide by their "Community Commitment,"[10] and reserves jurisdiction in the district

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over the same time period Blodgett would have taken to pay for the new hospital. See id. at 11-12, APX 568-69. Finally, the Commission argued that Blodgett could well be denied state permission to build the $187 million facility on which the efficiencies estimate was based, in light of community opposition, the availability of less expensive alternatives, and Michigan's certificate of need regulations (see pp. 39-40, infra).

[10] The "Community Commitment," contained in the "Statement of Actions Planned in the Event of a Merger" submitted by defendants to the district court (R.62), includes, inter alia, a promise, "in perpetuity," to "target a five year rolling average total margin for the merged system that does

court to enforce compliance during the pendency of any appeal from the court's order and during the pendency of any FTC administrative adjudication and appeal from any order entered in such an adjudication (R.206, APX 77-79). (The "Consent Order" was not consented to by the Commission, which argued throughout the proceeding that the "Community Commitment" could not replicate the results of competition between Butterworth and Blodgett (e.g., R.70 Plaintiff's Response to Defs. Stmt. at 9-19, APX 113-23; R.200 Op. 30-32, APX 62-64)). By separate order of October 28, 1996, the court denied the Commission's request for preliminary injunctive relief and granted judgment for defendants (R.207, APX 96-97).

SUMMARY OF ARGUMENT

The Clayton Act prohibits acquisitions whose effect "may be substantially to lessen competition," and the district court's own findings of fact establish the elements of a powerful Clayton Act case. The merger of Butterworth and Blodgett would combine the two pre-eminent hospitals in Grand Rapids and increase concentration in already concentrated markets well above levels found to establish a prima facie violation of law. Moreover, unlike many merger challenges, in which courts must make a predictive assessment whether the acquisition is likely to facilitate the collective exercise of market power by the remaining market incumbents (through collusion or other interdependent behavior), the court here found "no question" that the combined Butterworth/Blodgett by itself "would have substantial market power in two relevant markets." Finally, the court recognized, as the defendants freely admitted, that a principal purpose of this

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not exceed the average of Moody's and Standard & Poors' upper quartile total margins for other health systems nationally;" an undertaking to freeze list prices at current levels for three years and to limit list price increases for an additional four years; and a commitment to level the playing field with respect to managed care, by offering the four largest managed care companies (for the first three years) rates equal to the weighted average of the rates currently paid to both hospitals by these plans, with rate increases in the succeeding four years increasing annually "by no more than the increase in the regional all-products CPI" (R.206, Att. 1 at 3-7, APX 83-87).

merger was to enable the combined entity to exercise the "substantial market power" that the merger would create, by eliminating the price reductions that competition has forced them to offer to some large managed care providers and refraining from such reductions in the future -- a process euphemistically described as "leveling the playing field." Stronger evidence that a merger "may substantially lessen competition" can scarcely be imagined.

The court, however, declined to enjoin the acquisition, because it agreed with the hospitals' contention that "even though competition may be lessened, the interests of consumers are * * * likely to be advanced by the merger." In making this judgment, the court failed to apply the governing legal standard and thereby abused its discretion.

The antitrust laws in general, and the Clayton Act by its express terms, forbid conduct that may substantially lessen competition. The Congress (through antitrust exemptions) or individual states (through legislation invoking the "state action" doctrine) may decide that competition should be replaced with price-regulated monopoly or oligopoly in particular segments of the economy. But neither Congress nor the State of Michigan has made such a legislative choice here, and neither the district court, nor the boards of directors of the merging hospitals, may impose such a legislative choice themselves. (**POINT I.**)

The district court's extraordinary ruling may not be justified on grounds that the merging entities are nonprofit institutions governed by boards of directors comprised of public-spirited community members. The Supreme Court and the courts of appeals have routinely rejected nonprofit status as an allowable reason for approving otherwise anticompetitive mergers or other commercial conduct. The district court's attempt to circumvent this caselaw with a broad, purportedly empirical conclusion that nonprofit hospitals behave differently from other firms in highly concentrated markets rests on a clearly erroneous evaluation of controversial testimony provided by a single hospital industry witness. But even if one defers to the court's assessment of this evidence, no difference identified by the court can, under a rule of law prohibiting mergers that "may substantially lessen competition," justify a merger that the district court itself found would eliminate competition and create a quasi-monopoly provider. (**POINT II**.)

Nor may the district court's decision to deny injunctive relief be supported by the court's cursory finding that the merger would yield "in excess of $100 million" in efficiencies that the hospitals would supposedly pass on to consumers or use to create a "world-class" health facility in western Michigan. As the court itself recognized, consideration of efficiencies in merger analysis is relevant only insofar as such alleged efficiencies would benefit competition. In the present case, the court failed to analyze or explain how the merger's alleged efficiencies would contribute to the competitive process at all. Moreover, the court did not even explain how it arrived at its $100 million figure in the first place. The court's inability to resolve the parties' "competing views" of efficiencies should itself have warranted rejection of this defense. (**POINT III.**)

Finally, whatever the validity of defendants' non-profit and efficiencies defenses, resolution of these novel issues by means of conclusory findings in a statutory preliminary injunction action constitutes a misapplication of the standard governing preliminary injunctive relief under Section 13(b) of the FTC Act. By the court's own acknowledgment, the Commission presented not merely a strong "prima facie" case, but established as well that this acquisition would create a dominant firm with "substantial market power." Such a showing is, by any conceivable measure, sufficient to raise "questions going to the merits so serious, substantial, difficult, and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance," FTC v. Freeman Hospital, 69 F.3d 260, 267

(8th Cir. 1995); FTC v. University Health, Inc., 938 F.2d 1206, 1218 (11th Cir. 1991). The court's failure to grant a preliminary injunction to permit resolution of defendants' novel defenses in the statutorily-prescribed administrative proceeding was, for this reason as well, an abuse of discretion. (**POINT IV.**)

ARGUMENT

I. THE DISTRICT COURT ERRED AS A MATTER OF LAW AND THEREBY ABUSED ITS DISCRETION BY DENYING INJUNCTIVE RELIEF ON THE GROUND THAT THE MERGER WOULD BENEFIT THE PUBLIC INTEREST "EVEN THOUGH COMPETITION MAY BE LESSENED."

"The heart of our national economic policy long has been faith in the value of competition," Standard Oil Co. v. FTC, 340 U.S. 231, 248 (1951), and the antitrust laws "are designed to promote and protect competition in the marketplace," Axis, S.P.A. v. Micafil, Inc., 870 F.2d 1105, 1111 (6th Cir. 1989), cert. denied, 493 U.S. 823 (1989). To this end, Section 7 of the Clayton Act "creates a relatively expansive definition of antitrust liability" under which a "plaintiff need only prove that [a challenged merger's] effect 'may be substantially to lessen competition.'" California v. American Stores Co., 495 U.S. 271, 284 (1990) (emphasis in original). Because Section 7 was intended to arrest the anticompetitive effects of market power in their incipiency, FTC v. Procter & Gamble Co., 386 U.S. 568, 577 (1967), the statute "does not require a certainty, or even a high probability," that a merger or acquisition will substantially lessen competition, FTC v. Elders Grain, Inc., 868 F.2d 901, 906 (7th Cir. 1989); see Brown Shoe Co. v. United States, 370 U.S. 294, 323 (1962). "[D]oubts are to be resolved against the transaction." Elders Grain, 868 F.2d at 906.[11]

[11] As the district court recognized, because this case involves a statutory preliminary injunction in aid of an administrative proceeding, the Commission can carry its burden of demonstrating a likelihood of success on the merits simply by raising "questions going to the merits" that are

In the present case, the district court's own findings establish beyond question that the Butterworth-Blodgett merger "may" (indeed, almost certainly will) "substantially lessen competition" within the meaning of the Clayton Act. First, the court determined that the Commission had proven (for purposes of preliminary relief) the existence of both of the alleged relevant markets (general acute care inpatient hospital services in greater Kent County, and primary care inpatient hospital services in the Grand Rapids area) (R.200 Op. 7-18, APX 39-50); that both relevant markets were highly concentrated; that the merger would increase concentration to presumptively unlawful levels; and that "the FTC has established its prima facie case that the proposed merger would violate § 7 of the Clayton Act" (id. at 18-20, APX 50-52); see FTC v. PPG Industries, Inc., 798 F.2d 1500, 1507 (D.C. Cir. 1986) (showing of comparable increases in concentration deemed "overwhelming").

Then, going well beyond this strong prima facie case to address additional qualitative evidence bearing on anticompetitive effects,[12] the court found that substantial barriers to entry precluded the emergence of a new hospital to dissipate any market power created by the merger, and that the ability of the other two hospitals in Grand Rapids "to compete with the merged entity and defeat a small but significant price increase would be limited, especially for the foreseeable future." R.200 Op. 29, APX 61. Presented with consistent testimony by managed care firms, other insurers, and employers alike that Grand Rapids consumers insist on access to either Butterworth or Blodgett in their health care plans (see n. 5, supra), the court further concluded

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"serious, substantial, difficult and doubtful * * *." R.200 Op. 5, APX 37 (citing cases).

[12] Once the government establishes a prima facie case of illegality, it is the defendant's burden to rebut this presumption by clearly demonstrating that other qualitative factors indicate that the acquisition is unlikely to harm competition. See, e.g., FTC v. University Health, Inc., 938 F.2d at 1218-19; Olin Corp. v. FTC, 986 F.2d 1295, 1305 (9th Cir. 1993), cert. denied, 510 U.S. 1110 (1994).

that "[t]here is no question but that the FTC has demonstrated that the merged entity would have substantial market power in two relevant markets." R.200 Op. 41, APX 73. The court also acknowledged that prices to at least some consumers (e.g., managed care companies, their enrollees, and others currently enjoying discounts) would be higher if the merger occurs than if it does not, owing to the combined entity's anticipated power to dictate prices to large buyers (id. at 32-35, 41-42, APX 64-67, 73-74), and even implicitly recognized that defendants' overall prices may be higher as well, since defendants' power would enable them to defend their above-average profit margins from deeper and more widespread discounting in the future (id. at 33-34, APX 65-66).

The showing made by the Commission, as confirmed by the district court, far exceeds that found to warrant relief in other hospital merger cases. See FTC v. University Health, Inc., 938 F.2d at 1218-19; Hospital Corp. of America v. FTC, 807 F.2d 1381 (7th Cir. 1986), cert. denied, 481 U.S. 1038 (1987); United States v. Rockford Memorial Corp., 898 F.2d 1278 (7th Cir.), cert. denied, 498 U.S. 920 (1990).[13] In each of the referenced cases, the challenged merger would have reduced the number of hospitals in already highly concentrated markets, but left at least two firms capable of competing meaningfully with each other. The courts, applying well established antitrust doctrine, made the "probabilistic" judgment that the resulting increases in concentration in markets with high entry barriers created an "appreciable danger" that the merged entity would "cooperate (or cooperate better) with other leading competitors" in setting price and

[13] And notably, by its strong showing respecting the relevant geographic market (and defendants' inability to identify any plausible alternative markets, R.200 Op.17-18, APX 49-50), the Commission overcame the evidentiary failing that led district courts in the Eighth Circuit to deny injunctive relief against proposed nonprofit hospital mergers in two recent cases. See FTC v. Freeman Hospital, 69 F.3d 260 (8th Cir. 1995); United States v. Mercy Health Services, 902 F.Supp. 968 (N.D. Iowa 1995), appeal pending, No. 95-4253 (8th Cir.).

output and thus warranted antitrust condemnation. Hospital Corp. of America v. FTC, 807 F.2d at 1387. The present case is far stronger than these precedents because the district court found that "[t]here is no question" that a combined Butterworth/Blodgett, by itself, "would have substantial market power in two relevant markets" (R.200 Op. 41, APX 73).

Despite these findings, the district court denied preliminary injunctive relief and granted judgment for defendants, citing approvingly their view that, “even though competition may be lessened, the interests of consumers are, under the unique circumstances of this case, likely to be advanced rather than hurt" by the merger (R.200 Op. 40, APX 72). In the court’s opinion, the "selective price advantages" accruing to managed care firms (and their enrollees) as the result of existing competition "are hardly the sort of benefit the antitrust laws are designed to protect" (id. at 33, 34-35, APX 65, 66-67). According to the court, such competition had merely resulted in "cost-shifting" in which some directly-billed employers and consumers are purportedly overcharged in order to fund price reductions to managed care (id. at 33, APX 65). While acknowledging that the "defendants’ above-average profit margins" left room for further competitive discounting to employers who might seek the same advantages as managed care, the court concluded that such price reductions would be undesirable as well because "reduced operating margins simply mean less funds to reinvest in each hospital" (id. at 34, APX 66). The court thus found itself "not at all persuaded" that "continuation of the current competition among managed care organizations" would yield "benefits to consumers as a whole superior to those likely to be realized in the event of the merger" (id. at 34, APX 66) and rejected the Commission’s request for injunctive relief on condition that the new Butterworth/Blodgett submit to loose judicial supervision of its rates through embodiment of the "Community Commitment" in a court order (id. at 43-44, APX 75-76).

For reasons detailed below, we believe the district court erred profoundly in its judgment that a newly-created quasi-monopoly, subject to judicial regulation, would yield greater "benefits to consumers as a whole" than "continuation of the current competition." But even if the district court is correct, the dispositive legal point on appeal is that the court was not authorized to make such a judgment. As the Supreme Court has observed:

> a merger the effect of which "may be substantially to lessen competition" is not saved because, on some ultimate reckoning of social or economic debits and credits, it may be deemed beneficial. A value choice of such magnitude is beyond the ordinary limits of judicial competence, and in any event has been made for us already, by Congress when it enacted the amended § 7. Congress determined to preserve our traditionally competitive economy. It therefore proscribed anticompetitive mergers, the benign and the malignant alike * * * .

United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 371 (1963).

The antitrust laws rest "'on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress.'" NCAA v. Board of Regents, 468 U.S. 85, 104 n.27 (1984), quoting Northern Pacific R. Co. v. United States, 356 U.S. 1, 4-5 (1958); accord, National Society of Professional Engineers v. United States, 435 U.S. 679, 695 (1978). And, "[e]ven assuming occasional exceptions to the presumed consequences of competition, the statutory policy precludes inquiry into the question whether competition is good or bad." National Soc'y of Prof. Eng'rs, 435 U.S. at 695; accord, FTC v. Superior Court Trial Lawyers Ass'n, 493 U.S. 411, 424 (1990).

To be sure, the antitrust laws are intended to promote consumer welfare. Reiter v. Sonotone Corp., 442 U.S. 330, 343 (1979). But the antitrust laws undertake to achieve this result **by preserving competition**. FTC v. University Health, Inc., 938 F.2d at 1225. The district court mistakenly construed the underlying statutory goal (to promote consumer welfare) as a mandate to disregard the statutorily-prescribed means of achieving this goal (preserving competition). In so doing, the court impermissibly turned this law enforcement action into a referendum on the value of competition itself.

In deciding whether the preservation of competition in hospital markets would be beneficial for Grand Rapids consumers, moreover, the court injected dubious and unsupported personal views about desirable health care policy that are not shared by the Supreme Court. Stating that "[i]n the real world, hospitals are in the business of saving lives, and managed care organizations are in the business of saving dollars," the court concluded that "[m]anaged care organizations' interest in maintaining a competitive edge cannot be allowed to trump either hospitals' conscientious endeavors to continue to provide comprehensive, high quality health care * * *" (R.200 Op. 42, APX 74). The Supreme Court, by contrast, has taken a more measured view of the role of insurers as surrogates for health care consumers in analyzing marketplace dynamics:

> Insurers deciding what level of care to pay for are not themselves the recipients of those services, but it is by no means clear that they lack incentives to consider the welfare of the patient as well as the minimization of costs. They are themselves in competition for the patronage of the patients -- or, in most cases, the unions or businesses that contract on their behalf for group insurance coverage -- and must satisfy their potential customers not only that they will provide coverage at a reasonable cost, but also that coverage will be adequate to meet their customers' [medical] needs. There is thus no more reason to expect * * * insurance companies to sacrifice quality in return for cost savings than to believe this of consumers in, say, the market for engineering services.

<u>FTC v. Indiana Fed'n of Dentists</u>, 476 U.S. 447, 463 (1986).

In the same vein, the district court's conclusion that a judicially-regulated hospital monopoly is preferable to competition in Grand Rapids is untenable because the court made no effort to assign a value to competition itself as a means of promoting consumer welfare. Rather, the court assumed that competition in the provision of hospital services is a zero-sum endeavor, in which the benefit of any competitive discount is necessarily "illusory" because it can only result in shifting immutable costs from one group of consumers to another (R.200 Op. 33, APX 65).[14] The premise underlying the antitrust laws, however, is that the very process of competing for customers against market rivals itself forces firms to become more productive, to increase output and product quality, and to reduce costs and margins, thus "yield[ing] the best allocation of our economic resources, the lowest prices, the highest quality, and the greatest material progress." NCAA v. Board of Regents, 468 U.S. at 104 n. 27. The court's opinion fails even to consider the possibility that this premise might apply to competition between Butterworth and Blodgett -- let alone attempts to quantify the benefits to consumers that would be forfeited by eliminating such competition through the merger.[15]

For the reasons above (and others detailed in Parts II and III below), we believe the district court was quite mistaken in its belief that eliminating competition between Butterworth and Blodgett would be better for Grand Rapids "consumers as a whole." But in any event, the court was without authority to base a decision on its answer to such a question. Congress may, of course, choose to replace competition with rate regulation in specific industries, for better or for worse. See Breyer, Regulation and Its Reform (1982). And a single state, by legislation that

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[14] By such logic, of course, "consumers as a whole" would be better off if most goods or services were provided by benevolent "consumer cooperatives" or similar monolithic providers (regulated, of course, by the government) that could charge everyone a "fair," uniform price, eliminate the duplicative costs of maintaining competing enterprises, and devote their monopoly profits to the common good. Such an approach, however, has not been judged a great success in those countries in which it has been tried. See, e.g., Kaminski, The Collapse of State Socialism: The Case of Poland 200 (1993); Goldman, Lost Opportunity: Why Economic Reforms in Russia Have Not Worked 12 (1994).

[15] Although it was not the Commission's obligation to re-prove the value of competition in this case, record evidence shows that competition between Butterworth and Blodgett for the patronage of large purchasers has, as the Supreme Court's model predicts, benefited Grand Rapids health care purchasers "as a whole," and will likely continue to do so if not extinguished by the merger, by, among other things, creating powerful incentives for the hospitals to increase efficiencies, minimize costs, and lower prices to all consumers. See pp. 28-30, infra.

meets requirements of the "state action" doctrine, may likewise displace competition with a regulatory regime.[16] It is, however, beyond the power or discretion of a court in an antitrust enforcement action to determine that a solution other than the competitive one would be more beneficial to society, Philadelphia Nat'l Bank, 374 U.S. at 371, even if (in the court's opinion) it might be safer (National Soc'y of Prof. Eng'rs, 435 U.S. at 693-95), fairer (Superior Court Trial Lawyers Ass'n, 493 U.S. at 423-24), or more favorable to some competitors (Atlantic Richfield Co. v. USA Petroleum Co., 495 U.S. 328, 337-38 n.7 (1990)). As the Supreme Court has made clear, "[t]he judiciary cannot indirectly protect the public against this harm [allegedly caused by competition] by conferring monopoly privileges on manufacturers." National Soc'y of Prof. Eng'rs, 435 U.S. at 695-96. Because the district court's decision would do exactly that, it should be reversed.

[16] Anticompetitive conduct by private actors may gain "state action" immunity if the challenged restraint is "'clearly articulated and affirmatively expressed as state policy'" and "'the policy [is] actively supervised by the State itself,'" FTC v. Ticor Title Ins. Co., 504 U.S. 621, 633 (1992) (citation omitted). Such immunity is "conferred out of respect for ongoing regulation by the State, not out of respect for the economics of price restraint." Id. A few states have experimented with regulatory approaches to the hospital industry similar to that imposed by the district court here -- i.e., by passage of legislation authorizing mergers subject to state regulation of post-merger pricing. See, e.g., Mont. Code Ann. §§ 50-4-601, 50-4-605 (1995). However, the State of Michigan has no such legislation. (Indeed, an effort to secure immunizing legislation for this merger was reportedly rejected by state legislators because it would lead to a hospital monopoly in Grand Rapids. See "Promises, Promises," Modern Healthcare 26, 32 (Feb. 19, 1996)). Moreover, studies suggest that state regulation of hospital prices has not effectively reduced hospital costs or promoted efficient behavior. See, e.g., Antel et al., State Regulation and Hospital Costs, 77 Review of Economics and Statistics 416 (1995).

II. THE NONPROFIT STATUS OF THE MERGING ENTITIES CANNOT JUSTIFY THE DISTRICT COURT'S UNPRECEDENTED CONDONATION OF A MERGER THAT WOULD CONFER MARKET POWER UPON A SINGLE FIRM.

A. The District Court Committed Legal Error by Treating Defendants' Nonprofit Status as a Substantial Reason for Allowing the Merger.

Nonprofit organizations, when they sell goods and services in or affecting commerce, must obey the antitrust laws. See, e.g., NCAA v. Board of Regents, 468 U.S. at 100 n.22; American Soc'y of Mechanical Eng'rs, Inc. v. Hydrolevel Corp., 456 U.S. 556, 576 (1982). Appellate courts have uniformly rejected assertions that otherwise anticompetitive mergers by hospitals should be permitted because the merged entity would be a nonprofit corporation governed by a board comprised of community members. See FTC v. University Health, Inc., 938 F.2d at 1224; United States v. Rockford Memorial Corp., 898 F.2d at 1285; see also Hospital Corp. of America v. FTC, 807 F.2d at 1390-91.[17] By holding to the contrary, the court below committed legal error.

Although stating that the nonprofit status of the merging hospitals was "not a dispositive consideration" (R.200 Op. 27, APX 59), the district court's opinion plainly treats it as such. The five "considerations" that the court expressly identified as "[o]f critical importance" to its conclusion that the merger would benefit consumers (id. at 41, APX 73), all turn upon the fact that

[17] In United States v. Mercy Health Services, 902 F. Supp. at 989, the district court also rejected a defense premised upon nonprofit status. Two district courts have given some weight to nonprofit status in evaluating hospital mergers, but both concluded that the merger at issue was not anticompetitive for reasons that turned largely on market definition, an issue on which the Commission prevailed below. See FTC v. Freeman Hosp., 811 F. Supp. 1213 (W.D. Mo.), aff'd on other grounds, 69 F.3d 260 (8th Cir. 1995); United States v. Carilion Health System, 707 F. Supp. 840 (W.D. Va.), aff'd, 892 F.2d 1042 (4th Cir. 1989) (table). Moreover, the Seventh Circuit characterized Carilion's analysis as "unpersuasive" and refused to follow it. Rockford Memorial, 898 F.2d at 1286.

the merged entity would be a nonprofit hospital directed by local business executives and other individuals, assertedly dedicated to serving only the interests of the community.[18]

In concluding that defendants' nonprofit status warranted denial of preliminary injunctive relief, the court made two ostensibly factual points. First, it accepted the position, advocated by defendants' expert Dr. Lynk in his testimony and in a recent law review article, that increased market concentration among nonprofit hospitals is not correlated with higher prices, but rather with lower prices (R.200 Op. 21-26, APX 53-58). Second, the court observed that defendants' board members are local business and community leaders and found that the defendants' respective board chairmen, Richard M. DeVos of Butterworth and David M. Wagner of Blodgett, had "both testified convincingly that the proposed merger is motivated by a common desire to lower health care costs and improve the quality of care" (id. at 27, APX 59). These findings cannot, as a matter of law, justify the merger.

Turning first to the composition of the nonprofit hospitals' boards of directors, the argument accepted by the district court here is precisely the argument rejected by the courts of appeals in cases such as University Health and Rockford, which involved mergers of nonprofit

[18] The considerations cited by the court were that (1) "nonprofit hospitals operate differently in highly-concentrated markets than do profit-maximizing firms," (2) "the boards of these two hospitals are comprised of prominent community and business leaders * * *," (3) "both boards have given [their] commitment [to serve the greater Grand Rapids community] concrete form through the Community Commitment and their agreement to be legally bound thereby," (4) "the Court's obligatory concern for the welfare of consumers as a whole * * * sheds a different light on the issues than have many of the FTC's more narrowly focused contentions," and (5) "substantial cost-savings and efficiencies would be realized as a result of the merger" (R.200 Op. 41, APX 73). The first four of these considerations reduce to the single proposition (analyzed in Part I above) that the combined entity will price its services in a manner that benefits "consumers as a whole" because it is a nonprofit, community-run institution. The fifth consideration -- cost-savings and efficiencies -- is relevant only in light of the court's belief that the hospitals' nonprofit, community-run character, as well as the Community Commitment, assures that such alleged savings would "invariably be passed on to consumers" (id. at 40, APX 72).

hospitals directed by community members who were no less highly-regarded or public-spirited than Messrs. DeVos and Wagner and their colleagues. A firm, however well-intentioned, that lacks meaningful rivalry in its market simply cannot replicate the results of competition. Thus, as the Supreme Court has made clear, "good motives will not validate an otherwise anticompetitive practice." NCAA v. Board of Regents, 468 U.S. at 101 n.23; see University Health, 938 F.2d at 1224 (nonprofit, community-run hospital's "prior history of service to the public and procompetitive behavior" insufficient to rebut FTC's prima facie case); United States v. Rockford Memorial Corp., 898 F.2d at 1285.[19]

Moreover, the nonprofit defendants in this case do not even intend to try to replicate the results of competition in the post-merger market. As Mr. DeVos, the driving force behind this merger, has freely admitted, the defendants believe that competition in hospital markets "doesn't work" (PX 82: Devos Tr. at 80, APX 418) and is "not a way to control quality or price" (id. at 82, APX 419). Rather, defendants (and the court) believe that consumers would be better served

[19] The record in this case confirms the commonsense recognition underlying this legal authority, that the directors of large corporations, even non-profits, inevitably face legal obligations and organizational imperatives that impel them to act, to some extent, to aggrandize their institutions even where this conflicts with the interests of the public. Statements from defendants' own witnesses and employees establish that "[a]n individual hospital board is duty bound to make decisions that are sensible for its own institution, even though the cost to the community might be greater." PX 12 at 2, APX 407; accord, PX 85: Kennedy Tr. 34, APX 423; R.203 III Tr. 142, APX 285 (Kennedy); PX 137: Palmer Decl. ¶ 15, APX 467; PX 151: Governile Decl. ¶¶ 17-19, APX 492D. For example, despite repeated criticism by community organizations (see PX 23, APX 411; R.201 I Tr. 103-04, APX 174-75 (Palmer)), the pricing structure of both hospitals has enabled them consistently to earn unusually high profits. R.101 Stip. Facts ##51-53, APX 145; PX 144: Sommers Decl. ¶ 7, APX 475-76; PX 149: Williams Decl. ¶¶ 41-43, APX 490-91; PX 151: Governile Decl. ¶ 3, APX 492. Also, as the district court itself concluded, absent the merger, Blodgett's board claims that it will ignore strong community objections and "exercise [its] fiduciary responsibilities" by building a costly replacement facility that the court characterized as wasteful to consumers (R.200 Op. 39, APX 71).

by the merged entity's exercise of market power to impose what it determines to be appropriate prices, quality, and levels of service.

The remaining justification for the court's reliance on defendants' nonprofit status was research conducted by Dr. William Lynk, an economist with the Lexecon Corporation, a Chicago consulting group. The court concluded from Dr. Lynk's submissions that defendants had "demonstrated good reason to question the applicability of the traditional presumption that a significant increase in market concentration will lead to higher prices in connection with the merger of nonprofit hospitals" (R.200 Op. 23, APX 55).

As we explain in Part II.B.2., below, Dr. Lynk's work gives no reason at all to believe that the creation by merger of a nonprofit hospital with market power will beneficially affect hospital prices. But even if his work did give reason to "question" the value of competition in optimizing the price-quality mix among nonprofit hospitals, it would provide an argument only for legislative amendment to the antitrust laws, not for judicial denial of preliminary injunctive relief in this case. It is axiomatic that mergers resulting in undue increases in concentration are presumptively unlawful under Section 7 of the Clayton Act (see United States v. Philadelphia Nat'l Bank, 374 U.S. at 364; University Health, 938 F.2d at 1218), and mergers that create monopolies, or single firms with market power, are the least favored of all (see FTC v. Alliant Techsystems, Inc., 808 F. Supp. 9, 20-21 (D.D.C. 1992)). The court's reliance on Dr. Lynk's studies to overrule precedent in this fashion constitutes the very "inquiry into the question whether competition is good or bad" that the law "precludes." National Soc'y of Prof. Eng'rs, 435 U.S. at 695.

B. The Court's Conclusion that "Nonprofit Hospitals Operate Differently in Highly Concentrated Markets than Do Profit-Maximizing Firms" Is, In Any Event, Clearly Erroneous.

A finding "is 'clearly erroneous' when, although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." Anderson v. Bessemer City, 470 U.S. 564, 573 (1985). The district court's statement that, for purposes relevant to antitrust analysis, "nonprofit hospitals operate differently in highly concentrated markets than do profit-maximizing firms" (R.200 Op. 41, APX 73) meets this test. In reaching this broad legislative conclusion, and then applying it to decide the current controversy, the court disregarded case-specific evidence showing that these defendants have responded to the spur of competition (and would respond to its elimination) very much like for-profit firms. In place of this direct evidence, the court relied upon Dr. Lynk's testimony that high concentration is correlated with lower prices among nonprofit hospitals, an assertion that, even if correct, cannot logically be extrapolated to predict the behavior of an urban hospital that gains market power through merger.

1. Abundant Record Evidence Demonstrates that Grand Rapids Consumers Have Benefited from Nonprofit Hospital Competition and Would be Harmed by Its Elimination.

The record in this case is replete with evidence that competition between Butterworth and Blodgett has benefited Grand Rapids consumers, and that eliminating competition would harm those consumers, in the same ways as one would expect to occur if defendants were for-profit firms. For one thing, competition for patients has forced Butterworth and Blodgett to extend price reductions to large managed care purchasers and indemnity insurers (a point the court acknowledged), who compete with each other to make available high-quality, affordable health care to thousands of Grand Rapids consumers (a point the court overlooked in its harsh attack on managed care, See R. 200 Op. 42, APX 74). Moreover, defendants' vigorous competition for the patronage of managed care accounts, if not eliminated by the proposed merger, would inevitably exert a "spillover" effect, forcing the hospitals to offer price reductions to self-insured employers and other institutional health care purchasers as well. See R.203 II Tr. 236-38 (Leffler), APX 234-36; II Tr. 103-04 (White), APX 208-09; R.203 III Tr. 116 (Kennedy), APX 272; R.205 V Tr. 184 (Eisenstadt), APX 383. Indeed, defendants' own documents reveal that, prior to the merger, both Blodgett and Butterworth had planned, or even begun, to expand their competitive discounting to include employers and employer groups (PX 258 at 1,3 (in camera folder); APX 1097, 1099; PX 198, APX 496-97; PX 213, APX 500-03; PX 214, APX 504).[20]

The proposed merger would abort further expansion of the hospitals' discounting (e.g., PX 8 at 4, APX 405). Instead, the hospitals expressly contemplate exercise of the market power that the merger will give them to reduce and eventually eliminate existing price reductions to managed care plans (PX 5 at 19, APX 403; PX 82: DeVos Tr. 163-64, APX 420-21; R.206 Att. 1 at 4, APX 84)[21] and ultimately to eliminate all price reductions, including those to "indemnity plans [e.g., Blue Cross/Blue Shield] * * * individuals and self-insured groups" (PX 5 at 19, APX 403). The defendants will also use the market power this merger would give them to assure themselves continued high margins, rather than share those margins with consumers in the form

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[20] Butterworth, which had been less aggressive than its smaller rival Blodgett in offering price reductions, had determined that "the Hospital's discounting policy should change considerably in the future * * * to reflect the current managed care environment." PX 198, APX 497 (emphasis in original). Thereafter, Butterworth had decided to "negotiate with all of the HMO's * * * start[ing] with Blue Care Network" (PX 214, APX 504) and to "seek additional business as long as revenues received cover incremental costs" (PX 213 at 5, APX 503).

[21] Defendants intend to utilize their post-merger market power to stifle the growth of managed care, the "outside threats," because the hospitals are concerned about whether they can "compete if these deep pockets come into the market and play us off against each other in the big discount game." PX 242 at 1, APX 509.

of lower prices, as competition forces firms to do. The "Community Commitment," now an order of the Court, guarantees defendants the right, in perpetuity, to realize a five-year average margin equal to the "upper quartile total margins for other health systems nationally" (R.206, Att. 1 at 7, APX 87 (emphasis added)). It is hard to imagine many for-profit firms that would not happily trade the risks and rewards of competition for a position of market power complete with judicially-sanctioned margins equal to those of the most profitable competitors in their industry.

In addition to the strong incentives created by competition to reduce prices, the record also shows that competition between Butterworth and Blodgett has created corresponding imperatives for the hospitals to reduce costs. For example, according to Blodgett's strategic plan, Blodgett sought to "[r]educe operating costs to become low cost provider in Grand Rapids" and "[u]nderbid Butterworth on managed care/direct employer contracts." PX 219 at 9838, APX 506. Blodgett's Vice-President for Corporate Development echoed this approach in Blodgett's annual report, explaining that Blodgett had responded to payors' increasing sensitivity to the cost of health care by "totally reinvent[ing] the ways we work in order to meet the lowest prices [while] maintaining our outstanding quality of care" (PX 237 at 18.1025 , APX 508; see also, e.g., PX 280: Franzese Tr. 71-72, APX 517-18 (Blodgett officials stated that they lowered costs as a result of competition with Butterworth). Butterworth, for its part, has likewise sought to be "the lowest cost health care provider" (PX 195 at 2, APX 495), a goal that led to a $30 million cost-reduction program (PX 282: Governile Tr. 84, APX 520; see also PX 200 at 3969, APX 499 (Butterworth CEO indicates that cost-cutting measures were implemented because raising charges was not "feasible" in Grand Rapids).

In sum, though it was not the Commission's duty to prove it, the record below contains abundant direct, market-specific evidence demonstrating that the "faith in the value of competition" mandated by the antitrust laws, Standard Oil Co. v. FTC, 340 U.S. at 248, has been vindicated by the performance of the nonprofit hospital defendants in Grand Rapids.

2. Dr. Lynk's Controversial Scholarship Affords No Reason to Lose "Faith in the Value of Competition" Among Nonprofit Firms.

Largely ignoring direct record evidence that the force of competition is no less powerful in the Grand Rapids hospital market than elsewhere, the district court cited Dr. Lynk's published study of hospitals in California,[22] and post-hearing calculations performed by Dr. Lynk on data submitted by three insurers regarding prices charged by selected hospitals in Michigan, to find that "market concentration appears to be positively correlated not with higher prices, but with lower prices" (R.200 Op. 24, APX 56). From this observation, the court drew the inference, on which it substantially premised its denial of injunctive relief, that "nonprofit hospitals operate differently in highly concentrated markets than do profit-maximizing firms" (id. at 41, APX 73).[23] The district court insupportably used a simple correlation, which fails to control for the effect of local wage rates and other costs, to infer that a merger to market power would somehow cause the merged entity to charge lower prices.

As both Dr. Lynk and the Commission's expert, Dr. Leffler recognized, differences in hospital price levels between one area of a state and another spring principally from differences in costs, which exert an effect on price that is independent of market concentration (DX 1058 at 246, 249, 237, APX 1084, 1085, 1081; PX 318 at 7 & App. 1 at ¶¶ 9-10, APX 539, 550-51.

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[22] Lynk, "Nonprofit Hospitals and the Exercise of Market Power," 38 Journal of Law and Economics 437 (1995).

[23] While the court described Dr. Lynk's correlations as "undisputed" (R.200 Op. 28, APX 60), the Commission certainly disputed the relevant legal and factual inferences that the court drew from these correlations, as we discuss in the text.

Hence, an observed correlation between market concentration and price will merely reflect the overriding effect of cost, unless all of the factors that influence cost (e.g., wage rates, real estate costs, hospital quality, complexity of services, local tax support, etc.) can be accounted for (i.e., properly controlled). PX 318 at 9-10, 11-12, & App. 1 at ¶ 9, APX 541-44, 550; see DX 1058 at 258, APX 1092 (potential for bias exists whenever a pertinent variable has been omitted from consideration).

Because Dr. Lynk used price as the variable to measure the use of market power, it was imperative that he properly control for costs.[24] DX 1058 at 253-54, 258, APX 1089-90, 1092. Yet Dr. Lynk conceded that he did not directly control for costs,[25] that he never tested variables that might have served as indirect proxies for cost to see whether they were appropriate proxies (id. at 258-59, APX 1092-93), and that he did not use other, commonly-accepted proxies for cost, such as county wage levels (id. at 257, APX 1091).

The biasing effects of this admitted failure are manifest, and were largely conceded by Dr. Lynk himself. Most significantly, hospital markets in rural areas are typically more highly concentrated than those in urban areas (like Detroit, Flint, or Grand Rapids), because lightly populated rural areas can support fewer hospitals than urban areas. DX 1058 at 246, APX 1084.

[24] In contrast, Dr. Leffler dealt with this problem by using price-cost margin as his measure of a hospital's ability to set prices above the competitive level. PX 318, App. 1 at ¶¶ 9-10, APX 550-51. Because this measure directly takes account of a hospital's costs, there is no need to identify, and control for, the many factors that influence costs. Id. at ¶ 10. Dr. Leffler found a statistically significant correlation between market concentration and the margins earned by hospitals on their reimbursement from managed care companies, thus "provid[ing] very strong support for the general proposition that managed care providers in Michigan receive lower prices from hospitals where those hospitals face more significant competition." PX 318, App. 1 at ¶¶ 13-14, APX 552-53.

[25] DX 1058 at 257, APX 1091; PX 318 at 10-11, APX 542-43; DX 1058 at 253, APX 1089 (did not control for wage rates); PX 318 at 11-12, APX 543-44 (did not control for presence of high-cost teaching hospitals); PX 318 at 10, APX 542; DX 1058 at 259-60, APX 1093-94 (did not control for variation of case intensity within a DRG).

Labor costs, the largest single component of hospital costs, are generally lower in rural areas (id. at 250-51, APX 1086-87). Rural hospitals also face lower costs than urban hospitals because they tend to perform less complex procedures (id. at 251-52, APX 1087-88). And teaching hospitals, which have higher costs than non-teaching hospitals, are typically found in urban areas, not in rural areas (id.. at 252-53, APX 1088-89).[26]

Because hospital costs are lower in rural areas, which, for separate and independent reasons, are usually the most concentrated, Dr. Lynk's analysis demonstrates only that hospital prices are lower in low-cost rural areas and higher in high-cost urban areas. Id. at 259, APX 1093; PX 318 at 14-15, APX 544A-B. His analysis does nothing to show that allowing hospital concentration to increase in urban markets would somehow exert a beneficial effect on hospital prices in those markets.[27] Thus, Dr. Lynk's correlation studies cannot reasonably be used to show that mergers that confer market power upon nonprofit hospitals help reduce hospital prices, even assuming arguendo that the district court had authority to bottom its decision in this case on a conclusion so antithetical to the antitrust laws.[28]

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[26] There are no teaching hospitals in Dr. Lynk's highly concentrated markets (i.e., markets with only one or two hospitals), and a significant number of teaching hospitals in his less concentrated markets. PX 318, App. 2, APX 554; DX 1058 at 252-53, APX 1088-89.

[27] Dr. Lynk's published study of price/concentration correlations in California hospitals (n. 22, supra), suffers from the same weakness as his analysis of the Michigan data in this case: it does not control directly for differences in costs among hospitals. See 38 Journal of Law and Economics at 445. Moreover, other studies of California hospital markets, which are dominated by nonprofit firms, have found a positive correlation between concentration and prices that is difficult to reconcile with Dr. Lynk's results. See Dranove et al., "Price and Concentration in Hospital Markets: The Switch from Patient-Driven to Payer-Driven Competition," 36 Journal of Law and Economics, 179 (1993); Melnick et al., "The Effect of Market Structure and Bargaining Position on Hospital Prices," 11 Journal of Health Economics 217 (1992).

[28] Dr. Lynk also conducted one piece of Grand Rapids-specific research, a study purportedly designed to test whether Butterworth and Blodgett currently exercise market power to raise prices for specific services for which they face little or no competition (R.200 Op. 23-24, APX 55-56). Based on this analysis of pricing of selected services by the Grand Rapids hospitals, the court

III. THE DISTRICT COURT ERRED AS A MATTER OF LAW AND THEREBY ABUSED ITS DISCRETION IN HOLDING THAT DEFENDANTS' EFFICIENCIES DEFENSE JUSTIFIED THE DENIAL OF PRELIMINARY INJUNCTIVE RELIEF.

In evaluating defendants' "efficiencies" defense, the district court stated that "to overcome the presumption arising from the FTC's prima facie case that the proposed merger would substantially lessen competition, defendants 'must demonstrate that * * * [the merger's] economies ultimately would benefit competition and, hence, consumers" (R.200 Op. 36, APX 68, quoting FTC v. University Health, 938 F.2d at 1223). However, the court failed to apply this test, making no determination that the efficiencies claimed by defendants would enhance competition at all. Moreover, the court did not even explain how it arrived at its conclusion that there would be substantial efficiencies, in the form of capital expenditure avoidance and operating efficiencies, "totaling in excess of $100 million" (R.200 Op. 40-41, APX 72-73). Rather, the court found "it neither appropriate or necessary to engage in a detailed evaluation of the competing views" (id. at 38, APX 70), but decided simply that savings from the proposed merger "would, in view of defendants' nonprofit status and the Community Commitment, invariably be passed on to consumers" (id. at 40, APX 72), and that such unspecified efficiencies therefore justified denial

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accepted Dr. Lynk's conclusion that "there is no positive correlation between market domination for a particular service and higher prices for that service" (id.). However, Dr. Lynk's analysis was based solely on list prices (i.e., charges), not actual transaction (i.e., net) prices (see R.204 IV Tr. 220-21, 230, APX 363-64, 366 (Lynk)). Given the frequency of discounting, analysis of list prices alone cannot validly measure the impact of market dominance. Moreover, Dr. Lynk's analysis fails properly to measure "market domination" because it isolates services like rhinoplasty (plastic surgery of the nose), which even Dr. Lynk admitted do not constitute "a meaningful monopoly" in Grand Rapids. R.204 IV Tr. 225, APX 365. Because the specific services (DRG's) measured by Dr. Lynk do not constitute separate product markets, they are not individually subject to the exercise of market power. Thus, one cannot reasonably cite a comparatively low charge for rhinoplasty or other DRG's as evidence of prices that would be charged by a Butterworth/Blodgett that enjoyed power in the markets for primary or all acute care inpatient services.

of preliminary injunctive relief. In light of these deficiencies, the court's acceptance of efficiencies as ground for denying preliminary injunctive relief against a transaction proven likely to create virtual monopoly power was wrong as a matter of law and therefore an abuse of discretion.

A. The Court Erred as a Matter of Law in Accepting an Efficiencies Defense Where No Finding Was Made (or Could Be Made) that the Benefits to Competition Outweighed the Costs.

Alleged efficiencies resulting from a merger are legally cognizable only insofar as they assist the court in evaluating the ultimate question -- i.e., the proposed merger's overall effect on competition.[29] One obvious example is a merger that enables two smaller market competitors to achieve lower costs and prices, and thereby compete more effectively with the market leader. See, e.g., United States v. Country Lake Foods, Inc., 754 F. Supp. 669, 680 (D. Minn. 1990). In such an example, a court might reasonably conclude that the benefit to competition from a stronger, lower-cost, lower-priced competitor outweighs the potential harm to competition from increased concentration and a reduction in the absolute number of competing firms. Thus "greater

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[29] Historically, the Supreme Court and some lower courts have been reluctant to permit the use of efficiency evidence at all in Section 7 cases. In Brown Shoe Co. v. United States, 370 U.S. at 344, the Court acknowledged that the proposed merger would benefit consumers by facilitating the development of large integrated or chain operations, but concluded that the legislative history foreclosed consideration of such factors. The Court stated: "Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favor of decentralization. We must give effect to that decision." In FTC v. Procter & Gamble Co., 386 U.S. at 580, the Court declared that "[p]ossible economies cannot be used as a defense to illegality. Congress was aware that some mergers which lessen competition may also result in economies but it struck the balance in favor of protecting competition." Accord, Ford Motor Co. v. United States, 405 U.S. 562, 569-70 (1972); RSR Corp. v. FTC, 602 F.2d 1317, 1325 (9th Cir. 1979), cert. denied, 445 U.S. 927 (1980) (rejecting argument that a merger of the second and fifth largest firms in the secondary lead market was justified merely because efficiencies achieved through the merger would enable the combined entity to compete more successfully with the market leader); Crown Zellerbach Corp. v. FTC, 296 F.2d 800, 825 (9th Cir. 1961), cert. denied, 370 U.S. 937 (1962).

market concentration is tolerated when the net result is to increase or facilitate competition," FTC v. Alliant Techsystems, Inc., 808 F. Supp. at 23. The present case, of course, is quite different, because here the merger will leave the merged entity with no effective competition and, as the district court recognized, give it single firm market power.[30]

Although some lower courts in recent years have demonstrated greater willingness to consider efficiencies in evaluating proposed mergers,[31] the scope of that inquiry is strictly circumscribed. As the Eleventh Circuit explained in FTC v. University Health, Inc., 938 F.2d at 1222 n.29, while evidence that a proposed acquisition would create significant efficiencies benefiting consumers is useful in evaluating the acquisition's overall effect on competition, "once it is determined that a merger would substantially lessen competition, expected economies, however great, will not insulate the merger from a section 7 challenge." See generally American Bar Association, Antitrust Developments 320 (3d ed. 1992).

The district court did not observe these boundaries, and its failure to relate the efficiencies it found to competition in the relevant markets is at odds with its statutory obligation to enjoin a merger that "may substantially lessen competition." Virtually every merger of two competitors has the potential to achieve cost savings through reductions in capital expenditures, administrative

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[30] A recently released FTC Staff Report, "Anticipating the 21st Century: Competition Policy in the New High-Tech, Global Marketplace" (Office of Policy Planning, May 1996) (reprinted in DX 1050), lists several other examples of situations in which efficiencies might be recognized. However, as that report observes, a "competitive dynamics framework makes it difficult to envisage a situation where efficiencies of any magnitude and probability could justify a merger that left only one or two firms in the relevant market" (DX 1050 at S-38, APX 1057) and likewise notes that, in view of the difficulty of measuring efficiencies, "[i]t therefore seems unlikely that efficiencies either could or would be the basis for a court's refusal to grant a preliminary injunction" (id. at S-37 to 38, APX 1056-57) in any case.

[31] See, e.g., FTC v. University Health, Inc., 938 F.2d 1206 (11th Cir. 1991); United States v. United Tote, Inc., 768 F. Supp. 1064 (D. Del. 1991); United States v. Country Lake Foods, Inc., 754 F. Supp. 669 (D. Minn. 1990).

overhead, advertising costs, and the like. If the Clayton Act's mandate of competition is to govern, however, even substantial efficiencies cannot warrant creation of a dominant firm "with substantial market power in two relevant markets" absent a showing that, by virtue of the claimed efficiencies, competition in the affected markets will somehow be enhanced. See FTC v. Alliant Techsystems, Inc., 808 F. Supp. at 23 (where merger would create firm with market power, efficiency claims are "insufficient to override the public's clear and fundamental interest in promoting competition").

It is doubtful that defendants could show that their merger's alleged efficiencies will enhance competition in this case. As even the district court implicitly acknowledged by entry of its extraordinary "consent order," any efficiency benefits that this merger may yield will be transferred to the public, if at all, only by the good will of a quasi-monopolist subject to judicial rate regulation, not by the processes of competition.

B. The District Court's Acceptance of an Efficiencies Defense on a Record So Equivocal that the Court Found Itself Unable to "Evaluat[e] * * * the Competing Views" Was Also Legal Error.

The district court's legal error in failing to relate defendants' claimed efficiencies to the ultimate issue -- the proposed merger's overall effect on competition -- is compounded by its failure to offer any basis for the conclusory assertion that those efficiencies would total "in excess of $100 million" (R.200 Op. 40, APX 72), or even to identify what portion of this $100 million estimate constitutes so-called "capital avoidance" and what portion reflects savings in (unidentified) operating expenditures. Because it was the defendants who bore the burden to establish efficiencies and demonstrate their bearing on competition in this case, the court's inability to evaluate the "strengths and weaknesses on both sides" and resolve the parties "competing views" should have led it to reject defendants' novel and speculative efficiencies defense. The court's adoption of that efficiencies defense to justify denial of preliminary relief against a merger that would "without question" create a single firm with market power was therefore wrong as a matter of law.

Certain efficiencies and benefits may accrue from almost any merger, including that small subset of mergers, like the present one, that raise serious antitrust concerns.[32] Because of the potential for justifying virtually every anticompetitive merger or acquisition on the basis of expected efficiency gains, and the difficulties inherent in measuring any such gains, courts that have entertained efficiencies defenses have recognized that they must be scrutinized closely. See, e.g., University Health, 938 F.2d at 1222-23 (rejecting poorly documented efficiencies claims and surveying proposals for limitation of the defense); United States v. Rockford Memorial Corp., 717 F. Supp. 1281, 1289 (N.D. Ill. 1989), aff'd, 898 F.2d 1278 (7th Cir.), cert. denied, 498 U.S. 920 (1990) (requiring "clear and convincing evidence" of claimed efficiencies, based upon Department of Justice Guidelines); see also IV Areeda & Turner, Antitrust Law ¶¶ 939-62 (1980); Areeda & Hovenkamp, Antitrust Law 796 (Supp. 1996) (suggesting that an efficiencies defense be recognized, but not in cases of mergers between large, already-efficient firms, because "the antitrust tribunal will seldom be able to quantify and balance the respective effects in particular cases").

The need for rigorous scrutiny of defendants' alleged cost savings is particularly compelling in this case. Defendants' claimed efficiencies are among the least convincing that have been proffered in defense of hospital mergers reviewed by the government. This is not a

[32] Of course, some mergers fail to achieve the purposes for which they undertaken, and thus yield no efficiencies at all, see generally, J. Brodley, "Proof of Efficiencies in Mergers and Joint Ventures," 64 Antitrust L.J. 576 (1996) , but presumably the potential for realizing efficiencies is one important reason for many transactions.

case, for example, in which declining local demand is insufficient to fill two hospitals, where a merger would therefore permit elimination of an entire physical plant or, as suggested by the district court (but nowhere explained) permit "efficiencies of scale" (R.200 Op. 42, APX 74). As defendants readily concede, both Butterworth and Blodgett are far above the average size for acute care hospitals, enjoy far above-average utilization, and operate at profit margins that substantially exceed those of comparable hospitals nationwide.[33] Rather than retire a facility, the proposed combined entity would embark on an ambitious construction project (including construction of a brand-new hospital at the eastern edge of Grand Rapids) in order to accommodate Blodgett's patient load. See DX 684 at 5, APX 817.

Defendants' principal claimed "efficiency" (so-called "capital avoidance") is simply the cost difference between the lavish, amenities-laden facility that an unmerged Blodgett would supposedly construct in order to compete with Butterworth, and the lesser facility that would be built to house Blodgett's patients if Blodgett had no need to compete. There is substantial doubt whether, even if the merger does not take place, an amenities-laden facility would pass Michigan certificate of need review,[34] particularly in light of past community opposition[35] and the possibilities for building a brand-new hospital for far less than $187 million. See PX 363 at 6-12, APX 563-69; DX 684 at 4-5, APX 816-17; R.205 V Tr. 270-71, 338-39, 341 (Taylor), APX

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[33] See R.101 Stip Facts ## 29-30, 42, 51-55, 117, APX 142, 144, 145, 152-53; PX 22 at 154, APX 410; PX 29 at 5, APX 414; PX 21, APX 408; PX 32 at 6, APX 416; DX 762: Veldman Tr. 78, APX 1020.

[34] Under the Michigan CON law, Blodgett must demonstrate that "in light of the alternatives available for consideration [a $187 million replacement] is the most efficient and effective method of meeting" its facility needs; and also that the capital costs of such an elaborate project would "result in the least costly total annual operating costs." Mich. Comp. Laws. Ann. § 333.2225(2)(a)(1), (b)(i) (1996 Supp.).

[35] See DX 685 at 28, APX 825; PX 292: Maurer Tr. 109, APX 525; PX 127: Knape Decl. ¶ 16, APX 447.

392-93, 399-400, 401. Moreover, to the extent that competition would compel an independent Blodgett to include in a new facility various "state of the art" features that could be omitted by a firm with market power, those features presumably represent benefits to consumers, the loss of which would require further reduction in the so-called "capital avoidance" savings supposedly yielded by the merger. A monopolist's ability to resist offering products or services that consumers would demand in a competitive market can hardly count as an "efficiency" that justifies a merger.

In addition to their large claimed "capital avoidance" savings, defendants alleged that the merger would achieve a somewhat smaller amount in operating efficiencies. These involve an array of routine savings, many of which could be achieved by the hospitals without a merger (see, e.g., PX 365 at VI-5, APX 623 (staff reductions relating to changes in length of stay and decreased nursing intensity); id. at A: 3, APX 574 (reduction in number of licensed practical nurses in pediatric intensive care); id. at A: 6, APX 577 (elimination of overstaffing in Blodgett's laboratory); id. at A: 12, APX 583 (elimination of positions in nursing administration), id. at A: 15, APX 586 (reduction of payroll assistant related to implementation of new technology)), and therefore are not appropriately attributed to the proposed merger at all. See, e.g., University Health, 938 F. 2d at 1222 n.30; United States v. Rockford Memorial Corp., 717 F. Supp. at 1289. Moreover, as the Commission pointed out, any cost savings that might be achieved by the merger could well be offset entirely by inefficiencies resulting from the loss of competition between Butterworth and Blodgett, such as the elimination of cost-reduction campaigns spurred by the hospitals' need to compete for the business of price-conscious managed care plans.[36]

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[36] See R. 202 II Tr. 230-32, 244-45, APX 229-31, 237-38 (Leffler); R. 204 IV Tr. 198-99, APX 357-58 (Lynk); PX 151: Governile Decl. ¶ 21-22, APX 493; PX 132: Loyd-Paige Decl. ¶ 7, APX 451; PX 219 at 4.9838, APX 506; PX 237 at 18.1025, APX 508; PX 282: Governile

In addressing the parties' contentions, the court acknowledged that "measuring the efficiencies of a proposed transaction is inherently difficult," and concluded that it was therefore "neither appropriate nor necessary to engage in a detailed evaluation of the competing views" (R.200 Op. 38, APX 70). We agree that the measurement of efficiencies is difficult. E.g., University Health, 938 F.2d at 1223; R. Posner, Antitrust Law: An Economic Perspective 112 (1976). That, however, is a reason, as noted above, why courts and commentators have recognized that efficiencies defenses must be carefully circumscribed, if not precluded entirely in suits for statutory preliminary injunctions, where complex issues can be addressed fully in the administrative proceeding.[37]

Defendants, of course, bore the burden to demonstrate that alleged efficiencies somehow outweighed the clear harm to competition caused by the merger. See University Health, Inc., 938 F.2d at 1222. Given the court's finding that this merger would "without question" create a firm with "market power," the court erred in declining to grant a preliminary injunction that would permit an administrative tribunal to conduct the "detailed evaluation of the competing views" (R.200 Op. 38, APX 70) that the district court determined could not be undertaken on the limited record before it.

IV. THE DISTRICT COURT ABUSED ITS DISCRETION BY FAILING PROPERLY TO APPLY THE STANDARD GOVERNING PRELIMINARY INJUNCTIVE RELIEF UNDER SECTION 13(b) OF THE FTC ACT.

Tr. at 84, APX 520; PX 305: Zech Tr. 136-37, APX 531-32.

[37] Moreover, even if a court's rejection of preliminary relief in an otherwise strong Clayton Act case could ever be premised on an efficiencies defense, the court must make findings that are sufficiently detailed to permit effective appellate review. The district court failed to do so here. See In re Allied Supermarkets, Inc., 951 F.2d 718, 726 (6th Cir. 1991); Grover Hill Grain Co. v. Baughman-Oster, Inc., 728 F.2d 784, 792-93 (6th Cir. 1984).

For the reasons detailed in the preceding three sections, the district court's denial of injunctive relief was wrong as a matter of substantive antitrust law. The court's denial of injunctive relief should also be reversed because the court failed to apply (though it correctly stated) the standard governing preliminary injunctive relief under Section 13(b).

As the district court recognized (R.200 Op. 5, APX 37), the Commission carries its burden of showing a likelihood of ultimate success in a 13(b) suit for preliminary injunction whenever it "raises questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals." University Health, 938 F.2d at 1218, quoting FTC v. Warner Communications, Inc., 742 F.2d 1156, 1162 (9th Cir. 1984) (quoting FTC v. National Tea Co., 603 F.2d 694, 698 (8th Cir. 1979)); FTC v. Freeman Hosp., 69 F.3d at 267.[38] The court's task in a 13(b) preliminary injunction proceeding is therefore "to

[38] In deciding whether to grant a preliminary injunction under Section 13(b), "a district court must (1) determine the likelihood that the FTC will ultimately succeed on the merits and (2) balance the equities." University Health, 938 F.2d at 1217. The district court's treatment of the first prong of this test is discussed in the text above. The district court did not address the second prong, balancing the equities, but reversal of the court's decision on the "likelihood of success" prong, in the circumstances of this case, would compel the conclusion that the equities warrant a full-stop preliminary injunction. "The principal equity weighing in favor of issuance of the injunction is the public's interest in effective enforcement of the antitrust laws." Id. at 1225. Although private equities may be considered, public equities receive far greater weight. Id.; Elders Grain, 868 F.2d at 905; FTC v. Warner Communications Inc., 742 F.2d 1156 at1165. Where the Commission has demonstrated "that it is likely that the proposed acquisition would substantially lessen competition, the [defendants] face a difficult task in justifying the nonissuance of a preliminary injunction," because a decision not to issue the injunction "would frustrate the FTC's ability to protect the public from anticompetitive behavior." University Health, 938 F.2d at 1225. The balance of the equities therefore generally follows the merits of the transaction, because "[i]f the acquisition seems anticompetitive, then failing to stop it during the administrative proceedings will deprive consumers and suppliers of the benefits of competition pendente lite and perhaps forever, for it is difficult to undo a merger years after it has been consummated." Elders Grain, 868 F.2d at 904. Neither defendants nor the court below identified any private equities that could possibly overcome the public's interest in enforcement of the antitrust laws. And as was demonstrated in Part I, it is beyond the court's authority to suggest that there are public

make only a preliminary assessment of the merger's impact on competition," Warner Communications, Inc., 742 F.2d at 1162, not to "resolve the conflicts in the evidence * * * or undertake an extensive analysis of the antitrust issues," id. at 1164. The merits are reserved exclusively to the Commission in its administrative proceeding.[39]

If the governing legal standard ("questions going to the merits so serious, substantial, difficult, and doubtful * * *") has any meaning at all, it requires the grant of a preliminary injunction in a case such as this one, in which, as the court held, "there is no question" that the merger is likely to create a firm with market power, and defendants' defenses to the Commission's strong showing of probable success on the merits implicate controversial, unresolved, and unprecedented contentions regarding the behavior of nonprofit firms and the significance of efficiencies.

As noted before, the court below found that the Commission had established all the elements of a very strong Clayton Act case. The Commission demonstrated first that the proposed merger "would result in a significant increase in the concentration of power in [the] two relevant markets, and produce an entity controlling an undue percentage share of each of those markets" (id. at 20, APX 52), thus "establish[ing] its prima facie case that the proposed merger would violate § 7 of the Clayton Act." Id. The bulk of the supplemental evidence significantly strengthened the Commission's prima facie case. This evidence included (1) substantial barriers

equities favoring the transaction that transcend the public interest in effective antitrust enforcement.

[39] As the court of appeals observed in Hospital Corp. of America, 807 F.2d at 1386:

> One of the main reasons for creating the Federal Trade Commission and giving it concurrent jurisdiction to enforce the Clayton Act was that Congress distrusted judicial determination of antitrust questions. It thought the assistance of an administrative body would be helpful in resolving such questions and indeed expected the FTC to take the leading role in enforcing the Clayton Act * * * .

to entry precluding new entrants that might deter the exercise of market power (R.200 Op. 28, APX 60); (2) the limited ability of the other two Grand Rapids hospitals "to compete with the merged entity and defeat a small but significant price increase * * * for the foreseeable future" (id. at 29, APX 61); and (3) extensive and uncontroverted evidence that Grand Rapids consumers insist on access to either Butterworth or Blodgett in their health care plans (see n. 5, supra), compelling the conclusion that "[t]here is no question but that * * * the merged entity would have substantial market power in two relevant markets" (R.200 Op. 41, APX 73).

The court's own findings thus demonstrate that the Commission made a showing far exceeding that found in other cases to warrant preliminary (and even permanent) injunctive relief.[40] As the Eleventh Circuit held under similar, but less compelling, circumstances:

> [T]he FTC has demonstrated that it likely will prevail in showing that the proposed acquisition would substantially lessen competition. The FTC's statistical evidence made out a strong prima facie case. The FTC bolstered its case by showing that a substantial barrier to entry exists in the relevant market. The [defendants] simply failed to introduce sufficient evidence to undermine the FTC's position.

University Health, Inc., 938 F.2d at 1224.

In stark contrast to University Health, the district court here found defendants' novel and controversial defenses -- nonprofit status and efficiencies -- dispositive in rebutting the Commission's strong showing of likely anticompetitive effects. The court reached this conclusion despite its recognition that both defenses were seriously controverted. For example, the court conceded that the Commission's concerns about defendants' nonprofit defense were not "unreasonable or unfounded," even though, "on balance," it accepted defendants' arguments (R.200 Op. 27, APX 59). On efficiencies, the court found "strengths and weaknesses on both sides," recognized that "measuring the efficiencies of a proposed transaction is inherently

[40] See University Health, 938 F.2d at 1218-19, 1224; see also Rockford Memorial Corp., 898 F.2d 920; Hospital Corp. of America, 807 F.2d 1381.

difficult," found that "both sides' estimates are clearly based in some measure on speculative self-serving assertions" and expressly eschewed any "detailed evaluation of the competing views" (id. at 38, APX 70). Given the concededly novel and unresolved contentions on which defendants' position rested, a proper regard for the governing legal standard and the statutory authority of the Commission to decide this case on the merits should have led the district court to grant injunctive relief pending resolution of the Commission's deliberations.

Indeed, the district court was sufficiently concerned about likely anticompetitive effects of the merger that it entered a "consent order" requiring defendants' adherence to temporary price and perpetual margin controls. Such an order could, of course, be justified only by the court's implicit finding that the merger is likely to violate the law.[41] If this merger is sufficiently problematic to warrant the imposition of such extraordinary judicial regulation, however, it surely raises questions that are "serious, substantial, difficult and doubtful" enough to compel the award of a full-stop preliminary injunction that will permit the Commission to achieve effective final relief should the merits be resolved adversely to defendants. See University Health, Inc., 938 F.2d at 1225; FTC v. PPG Industries, Inc., 798 F.2d at 1505-06.

CONCLUSION

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[41] The "consent order" does not identify any statutory authority for its entry. The court's only authority to entertain this lawsuit was Section 13(b), which authorizes the court to enter preliminary injunctive relief only upon finding that the statutory requisites (e.g., a likely violation of law) have been met. Thus, unless the district court's order is to be deemed ultra vires and void, it must necessarily be predicated upon an implicit finding that the merger is likely to violate the Clayton Act and that some relief is warranted. The presumptive relief under such circumstances, however, is a full-stop preliminary injunction, both because it prevents the interim loss of competition that would result from allowing a merger, and because it avoids the difficulties that typically attend efforts to restore independent competitors by means of divestiture. University Health, 938 F.2d at 1225; FTC v. PPG Industries, 798 F.2d at 1505-06; Warner Communications, 742 F.2d at 1165.

For each of the foregoing reasons, this Court should reverse the decision of the district court and remand this case with directions that the court enter an order preliminarily enjoining the proposed merger of Butterworth and Blodgett hospitals pending either dismissal of, or entry of a final order in, FTC Docket No. 9283.

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December, 1996

IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 96-2440

FEDERAL TRADE COMMISSION,
Plaintiff-Appellant

v.

BUTTERWORTH HEALTH CORPORATION, a Michigan corporation;
BLODGETT MEMORIAL MEDICAL CENTER, a Michigan corporation,
Defendants-Appellees

CERTIFICATE OF SERVICE

I hereby certify that on February 14, 1997, I have caused two copies of the "Brief for Plaintiff-Appellant Federal Trade Commission" to be served by first-class mail, postage prepaid, on counsel for Defendants-Appellees below:

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STATUTORY ADDENDUM

1. Clayton Act, § 7, 15 U.S.C. § 18, ¶¶ 1-2
2. Clayton Act, § 18, 15 U.S.C. § 21(a)-(c)
3. Federal Trade Commission Act, § 13(b), 15 U.S.C. § 53(b)

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Memorandum Opinion of the District Court, R. 200, filed 9/26/96
"Consent Decree", R.206, filed 10/28/96
Judgment Order, R.207, filed 10/28/96
Plaintiff's Notice of Appeal, R.208, filed 11/19/96.

II. OTHER DOCUMENTS

Answer, R.36, ¶ 8, filed 2/9/96 (first page and cited page only)
Plaintiffs' Response to Defendants' Statement of Actions Planned in the Event of a Merger, R.70, filed 3/22/96 (full document)
Stipulated Facts, filed 4/9/96 (full document)

III. HEARING TRANSCRIPT CITATIONS

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Tr. 103-04 (White)
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Vol. III Tr. 116, 142 (Kennedy)
Tr. 249 (DeVos)
Tr. 201 (Wagner)
Vol. IV Tr. 198-99, 220-21, 225, 230 (Lynk)
Vol. V Tr. 179, 184 (Eisenstadt)
Tr. 270-271, 303, 338-339, 341 (Taylor)

IV. EXHIBITS (first page of exhibit and cited pages (or pages with cited paragraphs) only, unless no pages are cited)

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PX 126: Kieffer Decl. ¶ 2
PX 127: Knape Decl. ¶¶ 9-11, 16
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V. IN CAMERA EXHIBIT (by order of District Court)

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